

THIS MONTH

IN CONSTRUCTION SUPPLY

JAN 2009

THE SHORTEST GREAT DEPRESSION ON RECORD



MARKET DATA

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By Greg Brooks. NAHB's latest projections were abysmal, to put it mildly: After nearly a 40% decline in housing starts in 2008, the association expects another 25% drop in '09.

But NAHB is right in line with the mood of the times. In December, *Bloomberg* dubbed this [The Great Recession](#) and warned of "the longest slump in the post-World War II era." *Fortune's*

["8 Really Really Scary Predictions"](#) include the Dow at 4,000, worldwide food shortages, and home prices in free fall for two more years.

And don't forget the Russian professor who predicts that the U.S. will have another civil war and [disintegrate in 2010](#). He made the *Wall Street Journal*.

Pessimism topped the charts in December, and all this bad stuff could happen (well, maybe not the civil war). On the other hand, maybe it's time to see if there's any good news out there.

Everyone agrees the economy won't come back until the housing market does. Two things have to happen to jumpstart housing: 1) Home prices have to bottom out so buyers will get off the dime and start working down unsold inventory, and 2) credit markets have to thaw so they can borrow money. According

to a study published in December by IHS Global Insight, prices are already back to historical norms.

Global Insight analyzed [prices in 330 markets](#) as of the end of the third quarter, 2008. Yes, they dropped like a rock. The result is that "extreme overvaluation is now essentially nonexistent." Only 31 markets are still overvalued by more than 15% while 214 are actually now *undervalued*.

That doesn't mean they can't overcorrect; in fact they are. [Prices dropped another 2.2% in October](#) and more foreclosures would drive them down further. But it isn't clear that foreclosures will continue at the current pace.

So far, most foreclosures have come from the subprime market, following resets that ran from mid-2007 through late

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(Continued from page 1) 2008. Another wave of resets is coming in 2009, but almost none of it is subprime. Those borrowers had higher credit scores so they presumably have greater financial means, and those loans were far less likely to include predatory fees or unreasonable rate caps. In theory, that means fewer homeowners will be unable to make their payments when their loans reset.

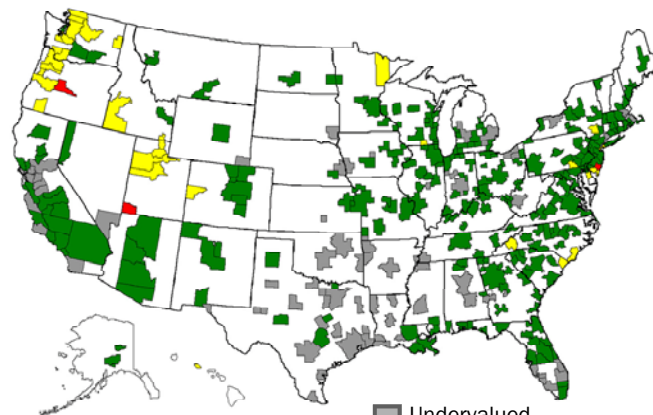
Many of them are underwater—one in six as of December—but that doesn't mean they'll all default. A 2007 study by the Boston Federal Reserve found that underwater homeowners who can make their payments usu-

ally don't default as long as they expect home values to recover eventually.

Which they should. In most markets, prices never got that far out of line to begin with and haven't fallen that far as a result, according to the [Office of Federal Housing Enterprise Oversight](#).

Pent-up demand will also boost prices once the market turns. Over the past 50 years, the average has been 112 permits per 100 new households—i.e., that's equilibrium between supply and demand. In 2008, the average was 40:100. Between 600,000 and 800,000 new households are still forming each year and many of them

HOME VALUES BY MSA, THIRD QUARTER 2008



- Undervalued
- Fairly valued
- Overvalued
- Extremely overvalued

Source: "House Prices in America," IHS Global Insight, December 2008

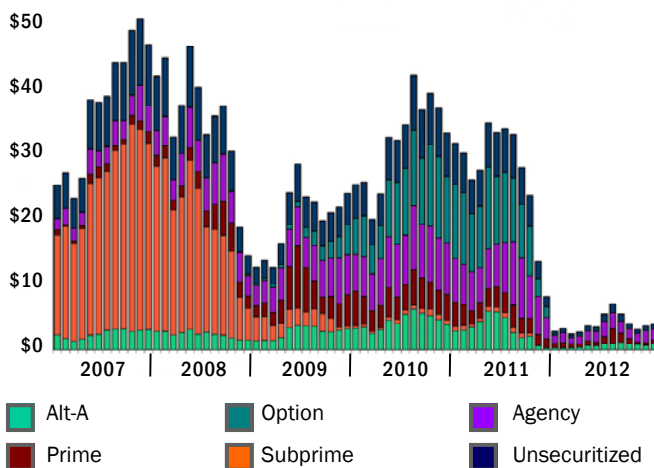
are qualified buyers; credit is the missing puzzle piece.

Doomsayers point to the Treasury Department's as-of-yet unsuccessful bailout of the financial sector as evidence that things will continue to deteriorate. In reality, there was no bailout. Of the [\\$373-odd billion committed to date](#), \$250 billion went to banks so they could lend it out and get credit flowing again. [Instead, they kept the money](#). Given the current climate, lack of oversight is unlikely to be an issue going forward.

As for the notion that the U.S. is on the verge of collapse, Americans and Russians both should take another look. According to [World Bank data](#), the U.S. accounts

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ARM RESET SCHEDULE (\$ BILLIONS)



Source: Credit Suisse

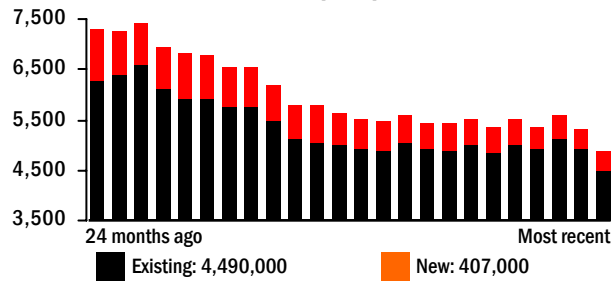
NEXT MONTH

THE BIG BAILOUT

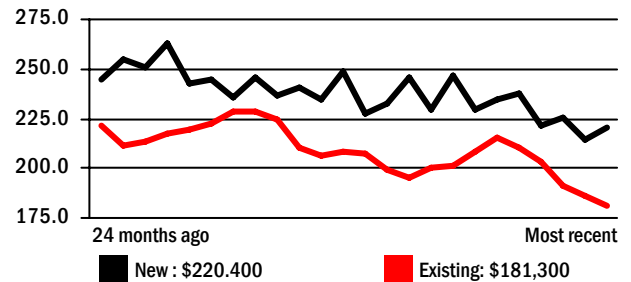
For better or worse, housing is nearing the head of the line at the Treasury Department Soup Kitchen. We'll examine foreclosure prevention programs and housing stimulus plans, and take an in-depth look at what the Obama Administration means for the channel.

VITAL STATISTICS

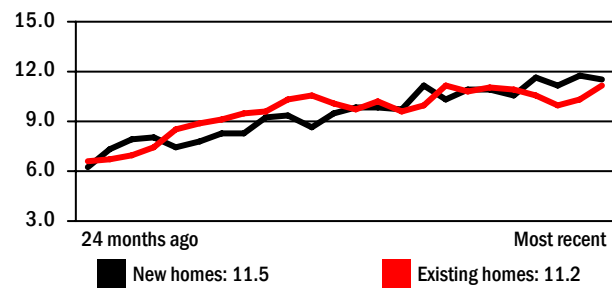
ANNUALIZED HOME SALES (000)



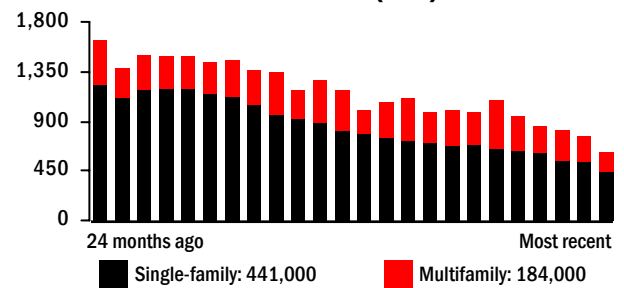
MEDIAN HOME PRICES (\$000)



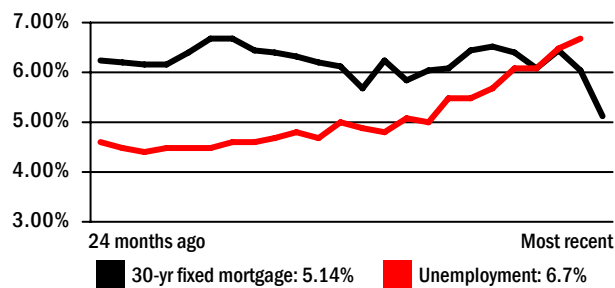
MONTHS' UNSOLD INVENTORY



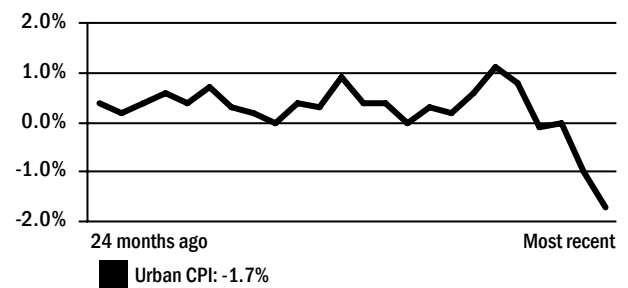
ANNUALIZED HOUSING STARTS (000)



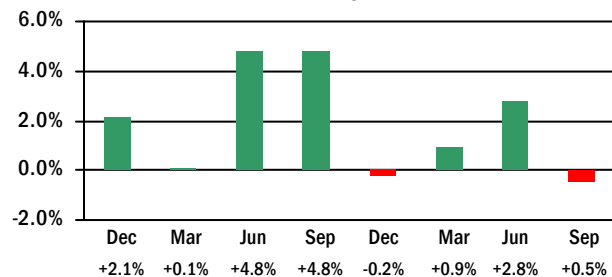
JOBS AND MONEY



INFLATION RATE



GDP CHANGE VS. PREVIOUS QUARTER



[Download current spreadsheet at CS24.us](http://CS24.us)

Sources: U.S. Census Bureau, National Association of Realtors, Freddie Mac, U.S. Bureau of Economic Analysis, U.S. Department of Labor. Data compiled by



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for 25% of world GDP and 25% of manufacturing output; China isn't even close. The Chicago Federal Reserve Bank says the primary reason we're losing manufacturing jobs is that productivity has been rising at an incredible 3% per year since 1949. That's no help if you lost your job, but it hardly qualifies as a competitive disadvantage.

If you're wondering whether we can maintain that edge, look at the World Economic Forum's latest annual [Global Competitiveness Report](#). Once again the U.S. is No. 1, slightly ahead of Switzerland, Denmark,

and Sweden, but well ahead of China (30), India (31), and Russia (51). If we're about to become a second-rate power, it's up to Switzerland.

That's not to say the downturn isn't serious or that it can't last as long as the pessimists say. But if it did, it'd be unprecedented.

This recession began in [December 2007](#), 13 months ago. As Bloomberg pointed out, the longest downturns since World War II (1973-75 and 1981-82) lasted 16 months. Even [the Great Depression only lasted 43 months](#) and no one did anything about it for the first 36.

When the recession does end, chances are the U.S. will lead the way—and housing will lead the U.S. as it has in seven of the past eight downturns. In 1975, housing starts jumped 11% in the three months before the recession ended, then another 14% in the next three months. In 1982, those increases were 19% and 24% respectively.

My advice: Continue to conserve cash and diversify beyond SF housing, but be thinking about what to do if the market takes off later this year because that's not out of the question. And don't believe everything you read. ☺



Greg Brooks is a leading industry analyst, a steering committee member at the Harvard Joint Center for Housing Studies, and a 40-year veteran of the construction supply business with 20 years' experience in the field.

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